

**STATEMENT OF DELTA AIR LINES, INC.**

**BEFORE THE  
SENATE AVIATION SUBCOMMITTEE**

**JUNE 4, 1998**

**REGARDING  
AIRLINE ALLIANCES**

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Delta appreciates this opportunity to appear before this Subcommittee and address airline alliances. Given the importance of these issues and the current debate about alliances, this forum is both timely and welcome.

Talk of airline alliances has dominated the media coverage of airlines. Why all of the attention? Why are governmental bodies so interested in this? The answer is simple -- the formation of alliances is rapidly changing the airline business as we know it. Alliances have taken cooperation to a new level. They are redefining the terms upon which airlines compete with one another.

What we are engaged in is nothing short of a major transformation of the industry. It is occurring in direct response to the demands of our customers. By forming these alliances we are responding to the needs of the marketplace. In turn, we are creating global networks that give hundreds of communities fast and efficient access to international commerce.

Mr. Chairman, today I would like to briefly address three key issues being considered in the context of alliances:

- How alliances are critical to industry growth and development

How alliances benefit consumers

The different forms alliances can take and a review of the Delta-United code share alliance

I will then comment briefly on the continued critical role of government in fostering pro-competitive alliances.

### ALLIANCES ARE CRITICAL TO INDUSTRY GROWTH AND DEVELOPMENT

Mr. Chairman, the competitive marketplace in aviation has changed dramatically in the past decade. Airlines must change and respond to this globalized economy. As our economy has grown more and more global in scale, U.S. passengers and shippers are now demanding access to destinations we never imagined flying. They want to go from anywhere to everywhere.

Within the past few years, the airline industry has begun to restructure itself to respond to the globalization of every element of our economy. Today, businesses and business travelers are demanding the ability to conduct seamless, global commercial transactions to serve their customers around the world. Every industry, including the airlines, has had to respond to this demand for more convenient access to the global marketplace.

In order to compete in the global race, we have had to change the way we do business and meet the demands of our customers for fast, convenient access to destinations throughout the U.S. and the world. Yet, responding to these changes in a traditional fashion was just too expensive. With the price of modern aircraft pushing \$150 million, carriers could not afford to devote resources to thin, untested international markets. The losses we experienced in the early 1990s -- especially in the international arena -- made carriers

extremely adverse to risky international expansion. Yet, knowing we had to respond to these changes, we devised a different approach.

The answer has been international alliances. Carriers have sought partners with strategically well-positioned international hubs. These hubs provide vast connecting complexes enabling passengers to conveniently connect to flights to a number of destinations. Each partner then takes advantage of the other's route networks by building "bridges" between the hubs. These "bridges" take the form of long-haul, intercontinental flights. Ideally, the result is seamless cooperation that allows customers to gain access to a vast new network created by the partner.

Airlines, including Delta, offer "seamless" transportation around the globe through marketing alliances and code share relationships with domestic commuter/regional air carriers, international air carriers and other domestic airlines.

This seamlessness is created in a number of ways, most prominently through code sharing and joint frequent flyer programs. Through code sharing, airlines are able to place their codes on the networks of their partners, thereby greatly expanding the reach of their route network without a major capital investment. It has proven extremely effective thus far in meeting the needs of growing demand for both domestic and international travel.

Competing networks are now forming that will link U.S. carriers with partners from Europe, Asia and Latin America. As these systems have grown, passengers and communities are enjoying convenient access to networks that will be able to get them to their destination in the most efficient manner possible.

From an airline perspective, these alliances provide an opportunity for growth. Delta's alliance partners have allowed us to put "our product" on the shelf in 70 international cities. This generated over \$100 million in incremental revenue growth last year. Employees, shareholders and suppliers have all benefited from this contribution.

Unfortunately, recent public attention on alliances has, once again, failed to adequately define and distinguish the different types of cooperation prevalent in the industry. This is essential in any evaluation of the public interest

benefits.

As previously mentioned, code sharing is the foundation for most alliances. Airlines place their code on the flights of another carrier, selling and marketing the service as their own. Code sharing can, however, take on decidedly different forms. The two types of code sharing alliances in existence achieve different commercial purposes. However, they both provide important consumer and public benefits.

### DEFINING CODE SHARING ALLIANCES

A. *Code Sharing without Antitrust Immunity* - This usually involves one carrier purchasing seats on another carrier. The marketing carrier then sells the seats to the general public as its own. The two carriers separately market and sell the inventory they possess on each flight. There is no price coordination between the carriers. In fact, carriers are forced to compete with one another to fill the inventory for which they have bargained. Northwest and Alaska Airlines have been doing this as have Continental and America West. Delta does this with a number of its international partners including Malev Hungarian Airlines, Aer Lingus, TAP Air Portugal, Korean Airlines and Transbrasil.

We also practice this form of code sharing with our regional U.S. partners -- Atlantic Southeast, Comair, SkyWest, Trans States and Business Express. When we sell a ticket on one of these Delta Connection carriers, we pay an established fee we have negotiated with that carrier for each passenger that is flown under the Delta code. This type of relationship allows us to expand our route network without the intensive capital investment of acquiring a new airline. It also provides the benefits of easy network access to a number of small and mid-sized communities.

We have recently seen announcements that Northwest and Continental and American and US Airways intend to form similar domestic code share alliances. These proposed domestic alliances emphasize the independence of their respective organizations and their plans to continue to vigorously compete against each other in the marketplace. This new type of domestic code sharing between major airlines is an innovative marketing step. It benefits consumers as well as the carriers. While each must be looked at on

an individual basis, the formation of this type of alliance is designed to expand consumers' access to the global marketplace.

*B. Code Sharing with Antitrust Immunity* - U.S. carriers are currently utilizing this type of code sharing on certain international routes. Given restrictions on foreign ownership and control of airlines, carriers are not allowed to merge with their international partners. By granting antitrust immunity, the Department of Transportation has adopted a policy that allows U.S. carriers and their international partners to operate as if they were a single carrier. Under this scenario, carriers are allowed to coordinate such disciplines as pricing, scheduling and sales and marketing. This type of relationship presents the best profit dynamic as carriers are coordinating their efforts rather than competing directly.

The network benefits of these alliances must outweigh the potential loss of competition to receive DOT and DOJ conference of antitrust immunity. That is the problem with the American Airlines-British Airways and American-TACA alliances. In both cases, the network benefits do not overcome the damage to competition in the U.S.-London and relevant U.S.-Central American city-pair markets.

The U.S. Government has permitted and encouraged the development of airline code share alliances because they produce invaluable public and consumer benefits.

### ALLIANCES ARE PRODUCING REAL BENEFITS FOR CONSUMERS

Airline customers are the driving force for the creation of alliances. Travelers and shippers want seamless access to air travel with a minimum of hassle at competitive prices.

As an unabashed supporter of pro-competitive airline alliances, Delta can speak firsthand about how these alliances have helped us to create the global network that we are building today.

#### Regional Partners

Our Delta Connection partners Atlantic Southeast, Comair, Trans States, SkyWest and Business Express provide, safe, reliable and convenient service

to hundreds of communities around the country. We have worked with these regional carriers to ensure that our schedules are coordinated to allow passengers to enjoy a seamless travel experience of single check-in for their ticketing and baggage needs. Delta's Connection partners are separate companies, owned and operated independently from Delta.<sup>1</sup>

### *International Partners*

In the international arena, we currently operate to 7 countries with our partner airlines AeroMexico, Transbrasil, Korean Airlines, Malev Hungarian Airlines, Aer Lingus, TAP Air Portugal and Finnair. We just received DOT approval to begin a comprehensive code share partnership with Air France that will greatly expand price and service options between the U.S. and France. With these carriers, we conduct a traditional code share operation. They place their code on Delta's services and we do the same on theirs. In each instance, we remain competitors. Through our code sharing agreement we purchase seats and market these destinations as our own; even though, in many cases, the aircraft may be operated by the other carrier. We remain competitive with these carriers in each market and consumers enjoy the benefits of more price and service options.

### *Atlantic Excellence*

Delta's Atlantic Excellence Alliance (AEA) was formed in 1994 with Swissair, Sabena and Austrian Airlines. In 1996, the four carriers applied for and received antitrust immunity from the Department of Transportation. This immunity enables us to closely coordinate all aspects of airline operations including pricing, scheduling and sales and marketing. The alliance currently operates 5,600 daily flights to 82 countries.

As compared to our other code share alliance arrangements, this immunized alliance was created to efficiently link the carriers' route networks in the U.S. and Europe. The AEA now has 23 transatlantic flights. The benefits to consumers and communities have been profound. Since 1996, the Atlantic Excellence partners have launched eight new transatlantic services. Thanks to the success of our alliance, we now have nonstop service between Cincinnati-Zurich and Cincinnati-Brussels. We have two nonstop flights to Brussels, Zurich and Vienna from New York. In Atlanta, we have double

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<sup>1</sup> Delta holds a 27 % equity stake in Atlantic Southeast Airlines, a 21% equity stake in Comair and a 15% equity stake in SkyWest.

daily flights to Brussels and Zurich and we now have nonstop service to Vienna. This U.S.-European level of service would be impossible to sustain without the efficiencies generated by our alliance.

These new transatlantic services have enabled us to link our U.S. network with the route systems of our European partners. Our Atlantic Excellence partners are able to display their code to 30 destinations in the U.S. In turn, Delta now displays its code to 46 destinations in 26 countries served by our Atlantic Excellence partners. For example, through our alliance relationship, Delta now serves places like Abu Dhabi in the United Arab Emirates, Kiev in the Ukraine and Kampala, Uganda -- places we could never profitably serve on our own. Yet through our alliance relationship, we are able to extend our network and offer our customers the type of seamless, convenient access they are constantly demanding. Our foreign partners are doing the same. They now have daily service to West Palm Beach, Salt Lake City, New Orleans, Phoenix and Lexington through the use of our large domestic network.

Mr. Chairman, these alliances work. They generate more service from more airlines to more cities than ever before. And, because we are competing with other pro-competitive alliances, consumers have a myriad of choices to get to their destination. Take, for example, a New Orleans passenger seeking to fly to Cairo. That passenger can travel via our Atlantic Excellence network through Atlanta or New York, or he or she could go via Detroit on the Northwest-KLM alliance or through Chicago on the United-Lufthansa alliance. This type of competition forces us to keep our prices competitive and schedule our flights for the optimum convenience of our passengers.

#### THE DELTA-UNITED CODE SHARE ALLIANCE WILL GIVE CONSUMERS MORE PRICE AND SERVICE OPTIONS

Two weeks ago, Delta and United announced their intention to form a code share alliance. Previously, Northwest and Continental and American and US Airways announced that they would also form domestic alliances. Each of the proposed alliances contain different features and qualities. The government must, therefore, look at each one on an independent basis. For example, Northwest-Continental involves questions of ownership and control that raise distinctly unique issues than those relating to Delta-United.



Delta's alliance with United is a cooperative venture that will provide tremendous public benefits and advance the customer driven trend toward global transportation networks. It will strengthen Delta's strategy of disciplined internal growth, build shareholder value and create more opportunities for Delta employees. All of these benefits will be achieved consistent with the government's desire to promote the formation of pro-competitive alliances.

Let me tell you how this will work.

- Delta will place its code on United's domestic route network. Every United flight in the U.S. will also carry the Delta code. Delta will be able to market and sell seats on every one of these flights. United will be able to do the same thing on the Delta system.

This venture will enable both companies to strengthen and grow their respective operations. We do not plan to reduce services. This alliance is about growth....not contraction.

Domestic competition will be increased as new competitive service options will be added at each of 13 U.S. Delta and United hubs/gateways and new nonstop price competition is introduced on 4,602 daily flights in 543 U.S. city pairs.

Frequent flyers will be able to accrue and redeem miles on both carrier's programs.

Every Delta hub will become a United hub and every United hub will become a Delta hub.

In the future, we hope to expand our combined services to cover our respective international networks.

Each carrier will remain independent and continue to compete with one another.

Most importantly, there will be no coordination on pricing. United will be able to sell seats on Delta at whatever price they deem appropriate and Delta will do the same on United. This ensures that the two carriers will remain

competitive.

Contrary to the characterization of some observers, this alliance will NOT lead to greater industry concentration or airline cartels. And, this is not, as some have suggested, a “virtual merger.” Delta and United will remain separate, independent companies. We have no plans to merge, nor will we be seeking antitrust immunity.

Code sharing and reciprocal frequent flyer programs will enable us to offer our customers increased on-line services to hundreds of new cities with more price and frequency options. This alliance constructively addresses one of the major concerns this body faces today -- competition and service in small and medium-sized communities. For example, consumers in 56 small and medium-sized communities will now have an additional carrier choice as a result of a Delta-United code share alliance. In the case of 14 of these cities, consumers will benefit from their first competitive service. We believe over time, additional flights and cities will be added as we seek to compete with other airlines and alliances that are being formed.

Our arrangement is structured in a way to ensure that each carrier is only rewarded if they compete successfully to attract new and additional customers. Since we are not sharing revenues or coordinating prices, each carrier must be vigilant to remain competitive IN EVERY CITY WE SERVE.

The Delta-United alliance also creates opportunities for job growth and enhanced security for our employees. I want to strongly emphasize that no work force reductions will result from the alliance. In fact, we think job expansion will occur.

#### GOVERNMENT POLICIES SHOULD CONTINUE TO FOSTER THE DEVELOPMENT OF ALLIANCES

I stated at the outset of this discussion that we welcome your assistance in crafting policies to address how alliances will operate in the future. Alliances are here to stay. They are the basis upon which we are building our future. We need to work with Congress and the Administration to ensure that carriers can react to this evolution.

The Department of Transportation, the Department of Justice and the GAO have all judged alliances to be in the public interest. DOT and the State Department have developed trade policies that foster the development of alliances. Thanks to their foresight and determination, the U.S. now has “open skies” agreements with 30 countries. Alliances were the catalyst for many of these market-opening agreements. The Administration has also granted limited antitrust immunity to allow a number of alliances to produce the network efficiencies created by cooperation.

By almost any measure, this policy has been hugely successful for consumers, communities and airlines. It has created a competitive environment where the marketplace, rather than artificial government barriers, determines how much service will be provided and what prices will be charged. Alliance formation has not dampened competition in the international arena. It has heightened it. Consumers now enjoy more flights from more carriers to more cities than ever before. But, we still have a long way to go to ensure that the regulatory environment facilitates pro-competitive alliance development.

We are very concerned about recent developments in Europe. The European Commission is on the brink of issuing regulations that will severely affect how alliances operate. We believe these actions are being taken without adequate analysis on how alliances have been functioning in the market. Despite a lack of findings to prove that alliances have harmed competition in the European Union, the Commission is prepared to go forward. This presents a serious question for companies seeking to form global alliances: what are the rules we are suppose to operate under and how often can they change?

If carriers are to create global networks with their partners, we need a sense of what the rules are and how they should operate. Alliances are transnational by definition, so we understand the need to subject ourselves to the rules and regulations of various jurisdictions. However, those rules must be coordinated between the home countries of the airlines involved. We cannot operate under a different set of competition rules in every part of the world. As alliances continue to respond to the competitive marketplace, airlines need certainty as to how they can cooperate. To this end, we urge U.S. and European competition authorities to immediately begin a high level dialog aimed at harmonizing competition guidelines and regulations for alliances.

Mr. Chairman, we cannot turn the clock back. Domestic code sharing has been a well-recognized element of our competitive U.S. landscape for nearly 20 years. Alliances have also been operating on the international scene for over a decade. They are producing enormous consumer and shareholder benefits. They are generating aircraft and other capital purchases. They are creating jobs. They are now a fixture in the marketplace. We must carefully examine each alliance to determine whether it meets established public interest principles that have been applied during the past 10 to 15 years. When it is clear that consumers have or will be harmed by an alliance, government has a duty to act. Otherwise, these ventures should be permitted to give consumers the choices they want.

Delta appreciates the opportunity to present our views to the Subcommittee. We look forward to working with you.